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FIVE THINGS YOUR INTERNAL PLAN TRUSTEE SHOULD KNOW

BRINGING A UNIQUE UNDERSTANDING OF KEY ISSUES FACING BENEFIT PLANS

FROM THE EDITOR - TANIA QUIGLEY, CPA

It has been a busy year for retirement plans. Both the CARES Act and SECURE Act brought with them new provisions that Plan sponsors needed to evaluate for implementation, and where necessary documents needed to be formally documented. In addition, many of the pension changes that have been put in place over the past few years need to also find their way into Plan documents, so it may make sense to evaluate your plan document with your third-party administrator to incorporate all necessary plan changes. While you're doing that, also consider optional plan changes such as auto enrollment, plan distributions for account balances under $5,000, etc. As these important changes are being managed and checked off your to-do lists, this is just the start. New standards have been issued by the AICPA for your ERISA retirement plan audits that will be taking place next year. The new standard brings clarity to the auditor's report in the area of limited-scope audits.

With keeping up to date on the ever-changing regulations surrounding retirement plans, it is important to refresh yourself on the basics. In this issue, we include a few important need-to-know items while managing your plan. These items are intended to help you keep your plan compliant with its plan document and ERISA regulations.

On another note, in these uncertain times, plan sponsors may decide to freeze their retirement plans. More often, it is defined benefit plans that become frozen, or have been frozen for several years, as plan sponsors find it costly to maintain these types of plans. Naturally, the next administrative step is to close them out. In this issue, we provide some information to plan sponsors that may be going through, or are considering going through, the process of terminating their plan.

This issue covers a wide range of information to help manage your plan, whether it is starting up, well established, or going through the termination process. We hope this issue brings clarity to some basic and new information for the retirement plans you sponsor. Our goal is to be a resource to you and your plan.

If you have any questions or we can be of any service to you, please don't hesitate to reach out.

CONTRIBUTORS

EDITOR

TANIA QUIGLEY, CPA
CERINI & ASSOCIATES, LLP
PARTNER, AUDIT

WRITERS

TANIA QUIGLEY, CPA
CERINI & ASSOCIATES, LLP
PARTNER, AUDIT

TED CAMPBELL, CPA, CGFM, CGMA
CERINI & ASSOCIATES, LLP
MANAGER

CRYSTAL HARVEY
CERINI & ASSOCIATES, LLP
SENIOR ACCOUNTANT

ASSOCIATE EDITOR

KEN CERINI, CPA, CFP, FABFA
CERINI & ASSOCIATES, LLP
MANAGING PARTNER

PAGE LAYOUT & DESIGN

KELLI-ANNE CERINI
CERINI & ASSOCIATES, LLP
MARKETING COORDINATOR

CERINI & ASSOCIATES LLP
CERTIFIED PUBLIC ACCOUNTANTS

CHANGES TO YOUR RETIREMENT PLAN'S LIMITED-SCOPE AUDIT

In July 2019, the AICPA issued a new standard, **Statement on Auditing Standards ("SAS")** No. 136, Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA. SAS No. 136 brings significant changes to the auditor's report in a retirement plan's audited financial statements, as well as modifications to the responsibilities of plan management and plan auditors for the audit, and updates to standards on certain audit procedures.

Retirement plans that undergo a limited-scope audit, will now be referred to as an ERISA Section 103(a)(3)(C) audit. The contents of the auditor's report change significantly with this new standard. These changes are to the layout of the report, the auditor opinion, and updated information about the responsibilities of plan management and the responsibilities and audit procedures of the auditor. The auditor's opinion will change from being labeled as a disclaimer opinion to having two opinions. The first opinion is on the reporting of the amounts and disclosures in the financial statements, in accordance with accounting principles generally accepted in the United States of America ("US GAAP"), that are not covered by the certification. The second opinion is on the accuracy of the certified assets of the plan that meets the requirements of the ERISA Section 103(a)(3)(C). The auditor's report also gives a separate opinion on the supplemental schedules.

The responsibilities of plan management and the auditor are outlined in the audit engagement letter and the auditor's report. Added responsibilities for plan management under SAS No. 136 includes the ability to determine that an ERISA Section 103(a)(3)(C) audit is permissible, the investment information is properly certified by a qualifying institution, and the certified investment information is appropriately measured and disclosed in accordance with U.S. GAAP.

Added responsibilities for plan auditors under SAS No. 136 is to meet the independence and ethical requirements relating to the audit. The requirement for independence and ethical standards is not a new standard for auditors, the update that comes with the SAS No. 136 is that it is now explicitly stated in these documents.

SAS No. 136 requires a draft of the plan's IRS Form 5500 to be completed and reviewed by the auditor prior to issuing the plan's financial statements. This is to prevent and correct any material inconsistencies between the audited financial statements and the IRS Form 5500, prior to the issuance of the audited financial statements.

Under SAS No. 136, more emphasis will be placed on the provisions of the plan document. Any findings from the auditor based on audit procedures to ensure compliance with the plan document will be communicated to management and evaluated for further disclosure.

SAS No.136 comes into effect is for periods ending on or after December 15, 2021 *(applicable to audits for 2021 plan year ends that are performed during 2022).*

We encourage plan management to communicate with your third-party administrator to ensure that they understand these new responsibilities and to become familiar with new version of the auditor's report. Lastly, any known differences in administering the plan to what is written in the plan document should be reviewed and either update current practice to match the plan document or amend the plan document.

TANIA QUIGLEY, CPA
PARTNER

TERMINATING YOUR DB PLAN

There once was a time when employees worked 25-30 years for the same employer and were rewarded for their loyalty and hard work with the benefits that come from an employer sponsored **defined benefit (“DB”)** plan. Unfortunately, these employees retired at age 65 and had a life expectancy of only a few more years. Up until the 1980’s defined benefit pension plans were the most prevalent and popular retirement plans offered by employers. According to the Bureau of Labor Statistics’ “*2018 National Compensation Survey*”, only 17% of private-sector workers have access to a defined benefit plan. If you are one of the private-sector employers within the remaining 17% of employers that still sponsor a defined benefit plan, and the cost of sponsoring the plan outweighs the benefits, here are a few options available to you:

1.FREEZE PLAN

Plans may be frozen at any time for any reason (*with 45 days notice to participants*)

a **“Hard freeze”** - entry to the plan is frozen by prohibiting new employees from joining the plan and benefit accruals are frozen for existing employees participating in the plan. A hard freeze does not freeze an existing employee, not fully vested as of the freeze date, from continuing to earn vesting credit while working for the organization.

b **“Soft freeze”** - entry to the plan is frozen by prohibiting new employees from joining the plan. Existing employees participating in the plan will continue to accrue pension benefits and vesting service.

2.CHANGE INVESTMENT STRATEGY

Liability-driven investing (“LDI”) may be implemented by shifting the focus of the plan in order to seek rates of return at or above the market-based growth of the liabilities rather than depending on equity to drive the funding of the pension plan. While LDI reduces the volatility of plan funding, it also has an opportunity cost from foregone equity returns by shifting to LDI.

3.FUNDING RELIEF

American Recovery Plan Act (“ARPA”) signed into law on March 11, 2021

a **Single Employer Plans**

- Funding shortfalls may be amortized over fifteen (15) years rather than seven (7) years
- ARPA allows for the usage of interest rates based on a 25-year historical average. The higher the interest rates a plan uses, the lower the present value of the liabilities (*which is important if you are looking to potentially terminate the plan*)

b **Multi-Employer Plans**

- ARPA will establish a fund with the **Pension Benefit Guaranty Corporation (“PBGC”)**, the federal insurance program, to provide assistance (“*distressed contribution*”) to multi-employer pension plans in danger of insolvency. The “special financial assistance” is designed to cover the amount required to pay all accrued benefits through the last day of the plan year ending 2051.
- A plan can apply for financial assistance through December 31, 2025, and would be eligible based on meeting one of the following conditions:
  - It was in critical and declining status in any plan year from 2020 to 2022
  - It applied to suspend benefit payments to pensioners under the provisions of the **Multiemployer Pension Reform Act (“MPRA”)**
  - It was in critical status in any year from 2020 through 2022 and had a modified funded percentage of less than 40 percent and the percentage of active to inactive participants in the plan was less than 40 percent.
  - It became insolvent after December 14, 2014 and was not terminated by the date on which the new legislation was enacted.

c **Other Pension Provisions**

- Sections 9702, 9703, 9705, 9706, 9707, and 9708 of ARPA provide additional opportunities for relief to both single employer and multi-employer pension plans based on the individual circumstances of the plan.

4.CONVERT TO A DEFINED CONTRIBUTION (“DC”) PLAN

This is typically done when employers freeze existing defined benefit plans. Employers converting to DC plans may not realize any cash flow savings relief initially, because their existing DB plan must be funded to pay for benefits for employees who are still owed for their pension benefits and the newly created DC plan will also have to be funded (although plan design and funding flexibility exists) at the same time.

In the long-term, a DC plan reduces the cost to an employer while also shifts the investment risk to the employee.

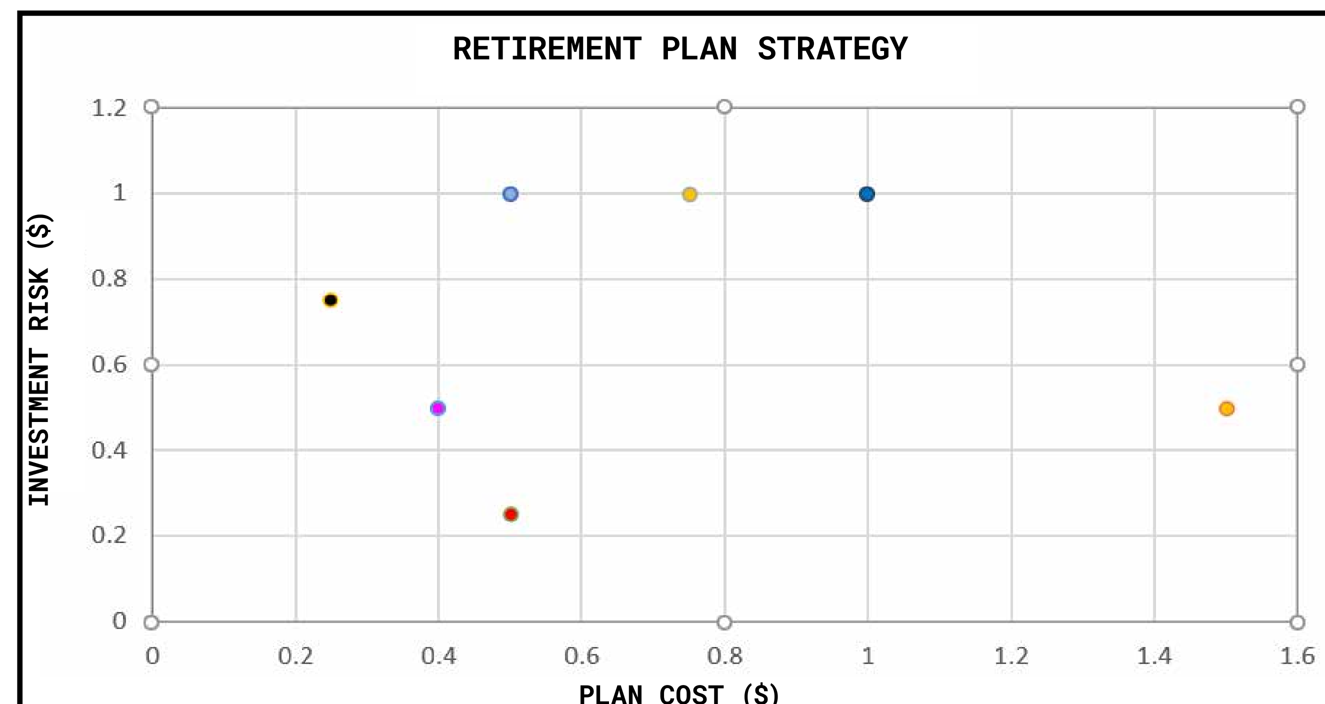
5.CONVERT TO A CASH BALANCE (“CASH”) PLAN

Cash plans (*also typically done when employers freeze existing defined benefit plan*) are really DB plans that require the plan sponsor to be responsible for investing assets and paying the benefits upon retirement, but the formula is based on a set contribution rate for current employees plus a fixed rate of return, which cannot be negative. The benefits received by an employee at retirement are guaranteed and based on their own “*account balance*”. The Cash plan can be attractive if an employee adopts an LDI investment strategy with a return on investment that exceeds the contribution rate, the true cost to the employer will be less than the contribution rate.

6.CONVERT TO A CASH PLAN AND OFFER A SUPPLEMENTAL DC PLAN

Employers offering both of these (again, this is also typically done when employers freeze existing defined benefit plan) plans enable employees to receive a guaranteed benefit amount at retirement from the Cash plan based on the employee’s “account balance”, but also provide supplemental retirement income to the employee. The Cash Plan will provide a conservative investment strategy allowing the employee to take more of an investment risk with their DC Plan investments, which hedges both market risk as well as interest rate risk.

Here’s a visual comparison of all plan options compared to the existing DB Plan (X and Y axis = 1)



TERMINATING YOUR DB PLAN - CONTINUED

If all of the above options have been exhausted, an employer sponsoring a DB Plan may terminate their existing plan via the following options:

1.STANDARD TERMINATION

This option requires that the plan has sufficient assets (*or adequately funded, which means the plan assets is not less than 80% of the plan's benefits payable/liability as of the liquidation/final distribution date*) to satisfy all benefits payable/liability as of the liquidation/final distribution date, regardless if the benefits payable are fully vested (see I.R.C. § 411(d)(3)). If the plan assets are not sufficient to satisfy the plan expense from the plan assets, the plan can (1) fund the expenses by the employer providing a supplemental employer contribution to the plan or (2) the "majority owner" can forego benefits (with spousal consent).

2.DISTRESS TERMINATION

This option is available when a plan does not have sufficient assets to pay all benefit liabilities under the plan. Since underfunded DB Plans are not allowed to be terminated without permission of the PBGC, under ERISA, the PBGC may grant permission to terminate the plan if one of the following situations exists:

- **a** **Liquidation -** the plan sponsor is undergoing liquidation under Chapter 7 of the Bankruptcy Code (*or an equivalent state law proceeding*).
- **b** **Reorganization -** the plan sponsor has filed a petition under Chapter 11 of the Bankruptcy Code, or similar state law proceeding, and the court determines that, unless the plan is terminated, the sponsor is unable to pay all its debts and will be unable to continue in business outside the reorganization process unless the plan is terminated.
- **c** **Inability to continue in business -** The plan sponsor demonstrates to PBGC's satisfaction that, unless a distress termination occurs, the plan sponsor will not be able to pay its debts when due and to continue in business.
- **d** **Unreasonably burdensome pension costs -** The plan sponsor demonstrates to PBGC's satisfaction that the costs of providing pension coverage have become unreasonably burdensome solely as a result of declining covered employment under all of the sponsor's single-employer plans.

If an employer/sponsor cannot terminate their DB Plan using the Standard Termination method and are unable to demonstrate to the PBGC that a Distress Termination should be granted, these additional options exist:

1.OFFER LUMP SUM CASH PAYMENTS TO BENEFICIARIES/PARTICIPANTS

Often times, terminated vested beneficiaries are targeted for lump sum cash payments, but offering lump sum cash payments to active participants is also a popular strategy. Lump sum cash payments may be made more enticing by offering to roll the lump sum amount over into a participants' DC Plan account rather than taking the entire payment as a taxable distribution all at one time.

2.PURCHASE ANNUITY FOR BENEFICIARIES/PARTICIPANTS

For beneficiaries/participants that do not elect to receive a lump sum cash distribution, an employer may purchase an annuity. Depending on the situation, sponsors may be able to finance the annuities by using investments held at a financial institution as "*collateral*", for example, if a sponsor holds long-term fixed income assets with a yield rate higher than the anticipated annuity payout rate, some financial institutions may permit sponsors from having to sell their long-term fixed income assets by providing "*margin loans*" collateralized with the long-term fixed income assets.

3.CHANGE FUNDING STRATEGY

- **a** **Increase contributions** - sponsors may accelerate their contributions to fund the plan (*if this is feasible*) by increasing discretionary contributions above the statutory requirements.
- **b** **Issue debt** - increasingly common approach, due to the low cost of borrowing, is to issue debt to finance DB Plans and enable sponsors to reach a fully funded position sooner than they otherwise would.

4.CHANGE INVESTMENT STRATEGY

As previously discussed, sponsors may adopt an LDI strategy if they have not already done so.

Please remember, that while sufficient funding is critical to sponsoring a DB Plan or allowing for the termination of a DB Plan, overfunding the Plan provides little benefit to an employer/sponsor. Once an employer/sponsor contributes to a plan, the funds cannot be accessed until all of the benefits are settled. If assets do remain upon termination, an employer sponsor has the following three options:

1. Assets can revert directly to the sponsoring employer. Under this approach, the employer is taxed at a 50% rate in addition to any normal corporate tax rates (*if applicable*).
2. The employer/sponsor can amend the plan to offer more generous benefits, but this option is rarely taken, particularly since terminating plans have often been frozen for years.
3. The employer/sponsor can choose to use the remaining funds to benefit the DB Plan participants through a different plan, known as a replacement plan. The participants in the terminating DB Plan must be in the replacement plan, and the employer/sponsor must direct at least 25% of the excess assets toward the other plan in order to reduce the version tax to just 20%.

We know that managing a pension plan can be very complex and time consuming and the laws continue to change, so please feel free to reach out to us as we would be happy to serve as a resource to your organization.

TED CAMBELL, CPA, CGFN, CGMA
MANAGER

FIVE THINGS YOUR INTERNAL PLAN TRUSTEE SHOULD KNOW

Being a plan trustee comes with a stringent set of responsibilities and necessitates having certain knowledge of the plan document, provisions, administrative operations, IRS filing requirements, and ERISA guidelines. Here are five things that should be considered on an ongoing basis to ensure that your plan trustee is keeping your pension plan in compliance and meeting the best interests of its eligible and active participants:

1.ENROLLMENT FORMS

Enrollment forms must be completed by all participants of a pension plan. These forms require the participant to indicate an affirmative election of how much of their compensation they would like to contribute to the plan, how they want their contributions to be invested among the various fund options your plan has, and who they would like to assign beneficiary privileges to. Enrollment forms should be completed once the employee becomes eligible to participate in the plan, as well as when participants would like to make a change to their deferral rate or investment allocation, or if they have a change in beneficiary.

It is becoming increasingly common for plans to have a custodian or recordkeeper that provides online access to participants to administer many plan transactions at the click of a button. If your plan has this feature and participants have the option to make changes to their elections electronically, it is crucial that the plan trustee maintain all notifications of changes from the custodian or recordkeeper and that these changes are then communicated to human resources and whoever is handling payroll. When changes to participant elections are made, they should be applied as soon as possible so that payroll withholdings are consistent with participant elections.

2.DEFINITION OF COMPENSATION

When calculating participant and employer contributions to the plan, it is important to know the definition of compensation per your plan document. The plan document will indicate what type of compensation should be used to calculate these contributions, including gross wages, overtime, bonuses, commissions, and fringe benefits or expense allowances. If you notice a discrepancy between what the plan document requires and what is actually happening in the payroll system, then an amendment of the plan document should occur to make the definition of compensation what the plan sponsor desires, or if the plan document is correct, the payroll system should be updated immediately to calculate deferrals appropriately.

3.SUMMARY ANNUAL REPORT AND FEE DISCLOSURE

The **Summary Annual Report ("SAR")** is a document that must be distributed to all plan participants within two months following the Form 5500 due date. If you filed an extension to file the Form 5500, then the SAR is due within two months following the extended due date. The SAR consists of a basic financial statement, which discloses plan expenses, the value of the plan's assets, the amount of plan contributions, and participants rights to additional information. Failure to distribute the SAR could result in **Department of Labor ("DOL")** noncompliance and hefty penalties. Delivering the SAR can be as easy as handing participants a hard copy at their workplace, including a copy with the participant's annual statement or as an addition to a company newsletter, mailing a copy directly to the participant's personal residence, or sending it electronically, so long as the participant consented to receiving pension-related documentation in this format.

As a plan trustee, you have an obligation under ERISA to carefully select and monitor plan investments and their activity, the options available to plan participants and their beneficiaries, and the service providers of the plan. Understanding the fees that correspond with these administrative tasks is important because plan fees and expenses are required to be "reasonable" and is imperative for participants to make the most informed decisions for their individual accounts. Fees may include plan administration fees for day-to-day operations, investment fees to manage the plan's investments, and individual service fees for certain individualized transactions, such as taking a loan. These fees can be deducted from investment returns or they can be charged to individual accounts either as a flat fee where everyone gets charged the same amount regardless of their account balance, or as a proportionate fee based on the participants individual account balance as a percentage of the entire plan's investment balance. It is the responsibility of the plan sponsor to ensure this fee disclosure gets into the hands of each participant of the plan prior to their initial enrollment and annually thereafter. This disclosure may be distributed via any of the same methods as the SAR, as indicated above.

Lastly, participants are entitled to receive a copy of the **Summary Plan Description ("SPD"),** which lays out all that the plan has to offer and how it operates. Any time the plan is changed, a document called a **Summary of Material Modifications ("SMM")** must be distributed to all plan participants notifying them of whatever changes have been made. This notification must occur no later than 210 days after the end of the plan year in which those changes were adopted.

4.MONITORING ELIGIBLE PARTICIPANTS

It is the responsibility of the plan trustee to notify employees upon hire and once they have met whatever eligibility requirements the plan has in place. Eligibility requirements are commonly attaining a certain age or working for the plan sponsor for a specified amount of time. Having an auto-enrollment provision in the plan document is a great way for plan trustees to ensure all eligible participants are properly notified. This requires employees to affirmatively decline participation or elect a deferral rate that differs from the auto-enrollment rate, otherwise the employee will begin to automatically receive pension plan contribution deductions from payroll once they have reached eligibility. If the plan document calls for employer contributions, it is important that all eligible employees are included in the employer contributions.

The total number of participants in the plan is what drives the pension plan audit requirement. The number of participants is calculated by adding actively participating employees (those that are making contributions), all eligible employees (whether they have yet to enroll or have elected not to enter the plan), and retired, deceased, or separated employees who still have assets in the plan. ERISA's general rule indicates that pension plans with 120 or more total participants at the beginning of the plan year are required to obtain an independent financial statement audit to be filed with their Form 5500. Once a pension plan has been audited, the requirement is that the plan receive an audit annually until the total number of participants at the beginning of the plan year falls below 100. An effective way to reduce the total number of participants in the plan and fall below the audit threshold is to ensure that an auto-distribution provision is included in the plan document. This provision is adopted so that participants with account balances under $1,000 or $5,000 are auto-distributed to an **individual retirement account ("IRA")**. The threshold can be $1,000 or $5,000, but the plan document needs to specify this in order for these distributions to occur.

From time-to-time, plan transactions occur that require distributions to participants, such as a newly adopted auto-distribution provision or a correction of error. It is the responsibility of the plan trustee to ensure that every possible effort is made to locate the individual. The DOL offers some guidance on this topic, stating the minimum steps that must be taken to locate a participant include sending a notice via certified mail, checking the records of the employer, sending an inquiry to the designated beneficiary, and using free electronic search tools.

5.FILING AND REPORTING REQUIREMENTS FOR FORMS 945 AND 1099-R

The plan sponsor is responsible for timely filing of IRS Form 945. This form is required if federal income tax was withheld from nonpayroll payments during the year. For pension plans, the most common types of payments that would prompt federal income tax withholding, and therefore requiring a Form 945 filing, are periodic distributions, required minimum distributions, and early distributions. The IRS Form 945 is an annual filing due January 31st of the year following the tax year.

The plan sponsor is also responsible for timely filing of IRS Form 1099-R. These forms must be issued for any participant that received a distribution exceeding $10 from the pension plan for the reportable tax year. Similar to the IRS Form 945, anyone who should be issued a 1099-R must be sent their forms by January 31st of the year following the tax year.

Take some time to review your plan document. Are participants' elected deferral rates per their enrollment form or custodian reports consistent with their payroll withholdings? Are those employee and employer contribution rates being applied to the correct compensation? When was the last time you reviewed the reasonableness of the fees being charged for your plan's administration? Have you considered an auto-distribution provision? Is your pension plan current on all of its required filings with the DOL and the IRS? These are just a few of the questions you should be considering as a plan trustee.

CRYSTAL HARVEY
SENIOR ACCOUNTANT

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P: (631) 582-1600 | **F:** (631) 582-1714 | **W:** www.cerinicpa.com | 3340 Veterans Memorial Hwy., Bohemia, NY 11716